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RUEHBU/AMEMBASSY BUENOS AIRES 1458
RUEHLP/AMEMBASSY LA PAZ SEP LIMA 0582
RUEHQT/AMEMBASSY QUITO 2422
RUEHSG/AMEMBASSY SANTIAGO 3764
RUEHGL/AMCONSUL GUAYAQUIL 0660
RUCPDO/DEPT OF COMMERCE
RUEATRS/DEPT OF TREASURY
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RUMIAAA/HQ USSOUTHCOM MIAMI FL

C O N F I D E N T I A L CARACAS 002718

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TREASURY FOR KLINGENSMITH AND NGRANT
COMMERCE FOR 4431/MAC/WH/MCAMERON
NSC FOR DTOMLINSON
HQ SOUTHCOM ALSO FOR POLAD

E.O. 12958: DECL: 09/07/2026
TAGS: [EFIN](#) [PGOV](#) [ECON](#) [VE](#)
SUBJECT: BRV SPENDING GROWING BY LEAPS AND BOUNDS

REF: A. 05 CARACAS 03643

- [1](#)B. 05 CARACAS 03172
- [1](#)C. CARACAS 00943
- [1](#)D. CARACAS 01067
- [1](#)E. CARACAS 02623

Classified By: ECONOMIC COUNSELOR ANDREW N. BOWEN
FOR REASON 1.4 (B) AND (D).

SUMMARY

[1](#)1. (U) From 1999 to 2006, BRV central government expenditures in dollar terms increased 95 percent and BRV central government spending as a percentage of GDP increased from 25 to 37 percent (including off-budget spending). In bolivar terms, BRV spending increased 700 percent from 1999 to 2006. The 2006 BRV budget as of August 3, 2006 allocates USD 40.5 billion, plus additional credits of USD 9.4 billion. Approved spending is directed mostly at social services (40 percent), transfers to the states (25 percent), and debt service (13 percent). In 2006, the BRV plans to spend little of its national budget on infrastructure, instead funneling resources through off-budget mechanisms such as the National Development Fund (FONDEN), which has received USD 15.8 billion since its inception in July 2005, and the Special Fund for Economic Development (FONDESPA). These fiscal and quasi-fiscal expenditures are targeted to maximize BRV political support and generate high, if unsustainable, levels of growth.

EXPENDITURE CLASSIFICATION

[1](#)2. (U) The table below shows actual BRV expenditures from 2001 to 2005, and 2006 planned expenditures (reftels A and B), including additional credits as of August 3, 2006. The National Assembly has approved USD 9.4 billion in additional credits this year (supplemental spending above the original budget), as compared to USD 2.1 billion in additional credits last year. Spending for the first half of 2006 increased 64

percent in dollar terms (and 83.5 percent in bolivars) over the same period in 2005 and now accounts for over 37 percent of GDP. (Note: The Central Bank (BCV) now claims to include spending by accounts other than the National Treasury, i.e. off-budget accounts, in its macroeconomic statistics. This is a significant development and, if accurate, could provide a better understanding of overall government spending in the future. That said, the BRV has been characterized by a lack of transparency with respect to state accounts. End Note.) Spending on the most significant budget categories is listed in the table below. Categories include: social spending, transfers to states, debt service, and defense. The other category includes transportation and communications, tourism and recreation, industry and commerce and other expenses.

	Social Spending	Transfers to states	Debt Service	Defense	Other	Total
2001	14,894	6,606	7,294	2,721	7,285	38,800
2002	10,428	4,539	8,879	1,676	1,771	27,293
2003	10,074	4,332	7,643	1,371	2,417	25,837
2004	13,280	5,670	7,032	2,010	4,064	32,056
2005	16,576	8,536	6,624	3,195	5,915	40,846
2006	20,181	12,389	6,709	3,121	7,495	49,865

(in USD millions)

Sources: Ministry of Finance, Central Bank, Official Gazette, and Embassy Estimates.

----- SOCIAL SPENDING -----

¶3. (U) From 2005 to 2006, the BRV increased social spending in dollar terms by 21.7 percent, reaching USD 20.2 billion (13.2 percent of GDP). However, social expenditures as a percentage of total central government spending have remained at approximately 40 percent during that time. (Note: When Chavez came to power in 1998 social spending amounted to approximately 5 percent of budgetary expenditures. End note.) Original budgeted social expenditures for 2006 included education (USD 7.3 billion), social security (USD 4.3 billion), health (USD 2 billion), social development (USD 1.7 billion), infrastructure (USD 600 million), culture and communications (USD 361 million), and science and technology (USD 261 million). These figures do not include significant off-budget spending by FONDEN, FONDESPA, and PDVSA.

¶4. (U) The 2006 planned social expenditures support ministerial expenditures as well as special social initiatives, both known for their inefficiency and poor administration. Major BRV education initiatives include the Simoncito program to meet the development needs of children 6 years and younger, adult educational programs and the "Bolivarian school initiative" to improve school infrastructure, purchase equipment and provide nutrition programs. Social security funding is designated for pension and retirement payments, employer contributions to the Venezuelan Institute of Health (IVSS), Social Security Institute for the Armed Forces (IPSFA), and Social Security Institute for teachers (IPASME). Health care funding is designated for food, pharmaceuticals, elderly poor, ambulatory services, medical equipment, medicines, and family planning and sexual education for adolescents.

¶5. (U) In July 2006, Finance Minister Merentes announced the BRV would spend USD 6.9 billion during 2006 on BRV Missions. Funding sources include: the central government budget (USD 837 million), additional credits (USD 1.5 billion), PDVSA trusts (USD 1.5 billion), and other sources (USD 3 billion), such as FONDEN (reftel C).

¶6. (U) After years of minimal spending, the Chavez administration finally identified additional funding to address infrastructure problems and the housing deficit, which has grown significantly in recent years (Note: Experts

estimate that Venezuela currently has a housing deficit of 1.68 million domiciles. The housing shortage is an endemic problem in Venezuela and has been increasing by approximately 60,000 homes a year. In 1998 the figure was approximately 1.4 million. End note.) The initial budget allocation for infrastructure was USD 600 million and approximately USD 1.549 billion of the additional credits support infrastructure. This funding supports mostly housing, but also includes improvements for potable water systems and highways, and neighborhood rehabilitation. Despite the focus on housing, local media report that, as of June 9, the BRV had completed just 27,165 housing units, or 18 percent of its 2006 housing goal of 150,000 units.

17. (U) The BRV plans to fund many of the highly visible infrastructure projects, such as roads, railroads, and energy projects, through FONDEN and FONDESPA (reftel C), rather than the 2006 national budget. As of July 7 FONDEN had disbursed USD 6.1 billion, with a reported USD 8.8 billion remaining in its accounts (see reftel E). In Chavez's September 3 weekly television show, "Alo Presidente," Finance Minister Merentes announced that FONDEN is currently working on 93 projects worth over USD 13 billion. Chavez added that FONDEN has received USD 15.8 billion to date. We estimate that FONDESPA has approximately USD 2 billion available to spend. The BRV has said that it will inaugurate many large infrastructure and transportation projects this year, including Caracas Metroline 4, a Cardiac Children's Hospital, and the train between Caracas and Cua.

TRANSFERS TO STATES

18. (U) Approximately 25 percent of approved 2006 central government expenditures represent transfers to the states. All but two of Venezuela's twenty-four states are headed by Chavista governors. From 2005 to 2006, the BRV increased transfers to the states by 45.1 percent to reach USD 12.4 billion (8.1 percent of GDP). States primarily receive their funding from the central government through three mechanisms: the Constitutional Allocation (20 percent of total ordinary government income), the Law for Special Economic Allocations (LAEE) (25 percent of oil and mines incomes after the deduction of the Constitutional Allocation), and the Intergovernmental Fund for Decentralization (FIDES) (15 percent of the value added tax). The Constitutional Allocation is distributed between states (30 percent) and municipalities (70 percent). FIDES is allocated by state based on three criteria: population (45 percent of the total), the state's physical size (10 percent), and its level of development (45 percent, with lesser-developed states receiving more funding). FIDES funding to each state is then divided between the state government (42 percent), municipalities (28 percent), and local councils (30 percent).

FIDES and LAEE also allocate funds to states for specific projects. In the original budget estimate, the Constitutional Allocation to the states received USD 5.3 billion, LAEE received USD 1 billion, and FIDES received USD 0.8 billion. Additional credits have included funds to address prior year obligations to the states. (Note: In May 2006, USD 287 million in FIDES funds from 2001 and 2002 remained undistributed. End Note.)

19. (SBU) According to an academic contact, state governments depend almost entirely upon the central government for funding. State governments can raise funds through the fees they charge for services (to change the title of a property, for example), but do not have significant independent powers of taxation. Municipalities receive disbursements from the federal government (including a percentage of the value added tax) and also collect a variety of local taxes on commercial activity, gambling, property taxes, etc. The 2006 budget assumes an average price for oil of USD 26/barrel, of which a percentage goes to the states. Additional proceeds from oil sales above this price (the average price for Venezuelan crude during 2006 has been USD 58.68) go to the central government, the effect of which is to cap state revenues.

Funds transferred from the Central Bank and PDVSA to FONDEN and FONDESPA avoid direct distribution to the states. The BRV also reformed the FIDES and LAEE laws to direct a portion of these funds in future budgets directly to community councils rather than regional governments, allowing greater Chavista influence at the local level (reftel D).

DEBT SERVICE

¶10. (SBU) The BRV plans to spend USD 6.7 billion (4.4 percent of GDP) for debt service, of which USD 1.2 billion will be from ordinary revenues (revenue from taxes) and USD 5.5 billion will come from issuing additional public debt (reftel D). This is almost the same in dollar terms as in ¶2005. Official statistics show a decrease in overall debt stock from USD 46.6 billion at the end of 2005 (36 percent of GDP) to USD 43.1 billion (28 percent of GDP) at the end of the second quarter 2006. (Note: The majority of this decline as a percentage of GDP is due to GDP growth rather than significant decreases in external debt. According to recent news reports, the BRV will issue additional debt in the second half of this year to cover its operating deficit and this may include the &bons de sur8 issued jointly with Argentina. End Note.) Most economists agree that Venezuela's debt load is manageable given the high oil price environment.

DEFENSE AND SECURITY

¶11. (C) From 2005 to 2006, Venezuela maintained approximately the same level of spending for security and defense. The 2006 expenditures of USD 3.1 billion (2 percent of GDP) for defense and security include maintenance of existing military systems and equipment, investment and construction projects, and the maintenance and repair of military infrastructure. (Note: This does not include the reported USD 3 billion deal for Russian fighter aircraft and helicopters. The source of funding for these purchases has not been announced. End note.) The budget stresses support to Mission Miranda, Chavez's military reserve force created in 2003 with prior enlisted military personnel. Despite the increases in funding, DAO reports defense funding shortages for equipment, travel, and fuel, among other areas. These shortages could be due to widely alleged corruption, mismanagement, diversion of funds, or as a result of Chavez favoritism. (Comment: Chavez is believed to be spending on the National Guard and Army, but minimally supporting the Navy and Air Force because he does not trust them. End comment.)

OFF-BUDGET EXPENDITURES

¶12. (SBU) In June of 2006, Ruth de Krivoy, former BCV President and local economic consultant, estimated that the BRV had USD 37 billion in public sector assets accessible in the banking system and public sector off-budget funds. She estimated that the BRV could sustain 10 months of public sector spending without any additional revenue. (Note: Santander, another respected economic consultancy, estimates this amount could be as high as USD 47 billion. End Note.) These amounts exclude approximately USD 35 billion in BCV reserves, which exceed the USD 25-29 billion that Chavez and the Central Bank consider as the adequate level of reserves (implying future raids on the BCV's international reserves). The BRV has announced that FONDEN and FONDESPA will fund much of the BRV Missions and various large scale transportation infrastructure, railroad, and energy projects.

ECONOMIC IMPLICATIONS

¶13. (SBU) BRV spending fueled by windfall revenues from oil revenues remains the primary engine for economic growth. With aggressive fiscal expenditures this year, local analysts anticipate economic growth at 7 to 9 percent for 2006. During the first six months of 2006, the BRV spent USD 24.6 billion, 64 percent more in dollar terms than during the same period last year. Despite the oil windfall, the BRV is running a central government deficit of over USD 2.4 billion (4.8 percent of the budget, or 1.5 percent of GDP). Analysts note that the BRV typically spends more aggressively towards the end of the year. Jose Guerra, former head of the BCV's Economic Studies Department, noted that BRV expenditures are outpacing revenue. If the pace of BRV spending continues, Guerra argues that the BRV will eventually have to devalue to address the fiscal gap. This huge injection of public funds into a controlled economy like Venezuela also creates strong inflationary pressures, which remains a major BRV political concern. Inflation is currently running at an annualized rate of 14.9 percent. BRV attempts to combat inflation will be discussed in septel.

¶14. (U) Local analysts criticize these expenditures as wasteful and unsustainable, and designed to create large constituencies dependent on the BRV for assistance. Handouts and make-work schemes from BRV Missions create disincentives to seeking employment, which in turn yields low official unemployment figures (9.6 percent for July 2006 according to the National Institute of Statistics). The government has also hired significantly more personnel and is increasing wages. The effectiveness of BRV expenditures is also hindered due to lack of technical skills and corruption in the BRV ministries and at the state government level.

COMMENT

¶15. (SBU) The BRV appears to have an insatiable appetite for spending. Instead of taking more orthodox measures to deal with windfall oil profits, such as paying down foreign debt and investing in stabilization or rainy day funds, the BRV seems willing and able to borrow and spend to win support at the ballot box in December 2006. These measures alleviate extreme poverty and increase GDP growth over the short and perhaps medium term, but are clearly unsustainable in the longer run when oil prices or production decline. Current estimates are that the BRV can maintain this high level of budgetary and off-budget expenditure and the imbalance between central government expenditures and revenues for at least the next two years due to continuing high oil prices and the purported USD 37) 47 billion stashed away in private banks and the public sector. When the boom does end, however, the BRV will have little to show for its years of excess.

WHITAKER